# RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS AND THE RISKS TO FINANCIAL STABILITY **ACCORDING TO THE REGION'S CENTRAL BANKS**

In 2022 the Banco de España identified five Latin American countries among those deemed to be of material significance to the Spanish banking system: 1 Mexico, Brazil, Chile, Peru and Colombia. This box reviews recent developments in their banking systems.

The data show that credit to the private sector in real terms (deflated by CPI) slowed notably in Chile, Colombia and Peru, but gained momentum in Brazil and Mexico (see Chart 1). In the case of Brazil, credit has been driven by loans to households and by the riskier lending

Chart 1 Bank loans to the private sector: real, by country (a)

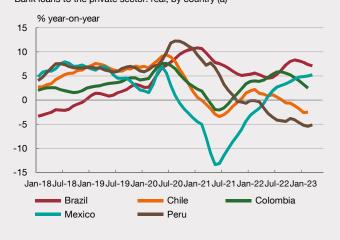


Chart 2 Bank loans to the private sector: real, by type of loan (a)

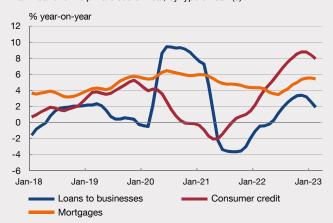


Chart 3 Private sector deposits: real (b)

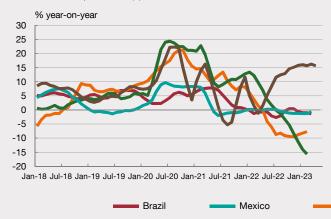
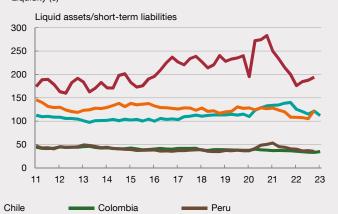


Chart 4 Liquidity (c)



SOURCES: National statistics, Refinitiv, IMF and Banco de España.

- a Real credit growth rates are calculated as the difference between the nominal credit growth rate and the CPI inflation rate. The aggregate for Latin America by type of loan is calculated as the average of the year-on-year rates of the five countries, weighted by GDP in purchasing power parity
- **b** Calculated as the nominal growth in deposits less the CPI inflation rate.
- c Defined as liquid assets divided by short-term liabilities, except in the case of Chile where it is the current ratio (current assets divided by current liabilities).

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<sup>1</sup> Each year, the Banco de España identifies third countries (i.e. outside the European Economic Area) that are materially significant to the Spanish banking system for the purpose of the countercyclical capital buffer (CCyB). To this end, the size of Spanish banks' international exposures is analysed according to the European Systemic Risk Board's guidelines. In 2023 nine material countries were identified - the United States, the United Kingdom, Turkey, the five Latin American countries mentioned above and Argentina (which is added to the list of material countries). See the section on the CCyB on the Banco de España's website.

Box 2

RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS AND THE RISKS TO FINANCIAL STABILITY

ACCORDING TO THE REGION'S CENTRAL BANKS (cont'd)

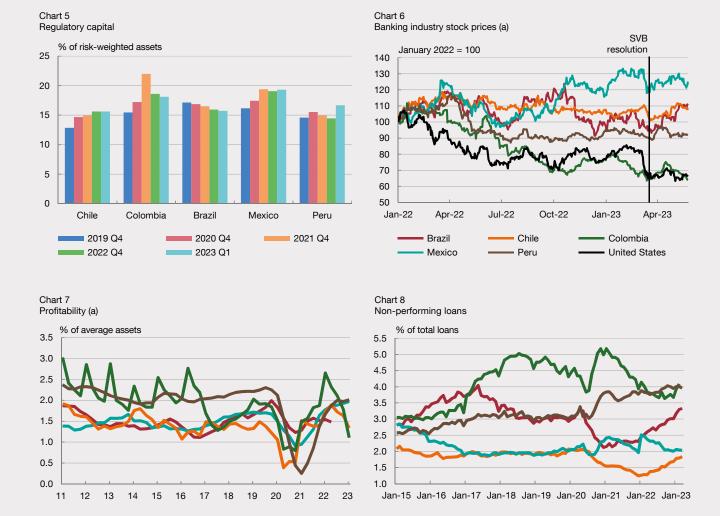
segments (such as credit cards), both to firms and to individuals. Moreover, "earmarked credit" (government-imposed bank lending for certain types of investment and construction) grew by around 10% year-on-year.

In the region overall, credit growth rates have eased across nearly all sectors since end-2022, although mortgage lending was more resilient (see Chart 2). Further, in countries for which data are available, loans denominated in US dollars grew faster than loans in domestic currencies owing to their lower interest rate cost, although their level of dollarisation stands close to pre-pandemic levels.

As regards bank funding, there was also a broad-based slowdown in real deposits growth over the course of 2022 (see Chart 3), even reaching negative rates towards the end of the period. The exception was Peru, where deposits growth gathered steam, especially in time deposits. As was the case in other emerging economies, Latin American banks brought debt placements on international markets to a standstill. Despite the negative performance in deposits, the standard liquidity ratios (liquid assets to short-term liabilities) revealed no significant impairment (see Chart 4).

Banks in the region have not experienced problems akin to those of some mid-size US banks and Credit Suisse,

Peru



SOURCES: National statistics, Refinitiv, IMF and Banco de España.

Brazil

a Return on average assets (ROA).

Mexico

Chile

Colombia

#### Box 2

# RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS AND THE RISKS TO FINANCIAL STABILITY ACCORDING TO THE REGION'S CENTRAL BANKS (cont'd)

which came to light in March 2023. Indeed, the capital ratios of the region's banking systems held stable above the regulatory requirements (see Chart 5), banks' stock prices have broadly risen in 2023 to date (see Chart 6) and the financial stability reports published by authorities ruled out any serious concerns related to the recent turmoil in the US banking system.<sup>2,3</sup>

Nor have profitability indicators shown any significant signs of deterioration; in fact, they increased in some countries thanks to stronger net interest income as a result of higher interest rates (see Chart 7). The main exception was Colombia, where profitability indicators declined due to provisioning expenses for non-performing loans (NPLs), whose share of total loans climbed further in early 2023 and is the highest in the region. NPLs continued to rise in the rest of the region and, with the exception of Mexico, returned to pre-pandemic levels (see Chart 8). This increase was driven, above all, by loans to households (except in Mexico), and within these by the riskier loans (e.g. credit cards in Brazil).

On the regulatory side, as a precautionary measure in view of the heightened external uncertainty, in May 2023

the Board of the Central Bank of Chile decided to activate the counter-cyclical capital buffer, setting it at 0.5% of risk-weighted assets and giving banks a one-year adaptation period. In Peru, the regulatory changes to align with Basel III requirements entered into force in January 2023, introducing a new capital framework for the financial system. The upshot was the total capital ratio rising from 14.5% in December 2022 to 16.4% in January 2023.

In their regular financial stability reports, the central banks or supervision authorities in Latin American countries of material importance to the Spanish banking system analyse recent developments in the main banking sector indicators, but also flag a series of risks to their banking systems.<sup>5</sup> In particular, the reports for the first half of 2023 identified certain risks that were common to all of these economies – including those discussed in this report – and other risks that were more specific to each country.<sup>6</sup> Figure 1 summarises the main country-specific risks for the Brazilian, Chilean, Colombian, Mexican and Peruvian banking systems according to their national supervisors.

<sup>2</sup> In its most recent financial stability report, the Brazilian central bank conducted a stress test taking into account the portion of debt that banks hold to maturity (4.2% of all assets in the system), finding that there were sufficient liquid assets in the system to cover potential cash outflows. Nor is the potential need to provide liquidity support to bank-linked investment funds thought to be a significant risk. The insolvency of the Lojas Americanas retail chain dealt a larger blow to confidence in the Brazilian banking industry, after the retailer filed for bankruptcy protection with around \$8 billion in debt and several banks among its main creditors. Nonetheless, the central bank concluded that the bankruptcy did not pose a risk for the financial sector as a whole (see the Financial Stability Report (text in Portuguese) of May 2023).

<sup>3</sup> In the case of Peru, the International Monetary Fund's recent review of the Flexible Credit Line includes a box on the subject, indicating that Peruvian banks did not face risks similar to those experienced by US banks because, among other reasons, assets held to maturity account for just 2% of total assets in the system.

<sup>4</sup> Colombian banks' return on assets (ROA) and their stock market performance may be shaped by, first, increased uncertainty over economic policy, and, second, by the various problems facing the Banco de Bogotá (such as handing direct control of Porvenir – a pension fund – to Grupo Aval – the bank's parent company –, and the spin-off of its Panama-based subsidiary AC Holding International, which operates in Central America).

<sup>5</sup> In all cases these are reports published by the central banks, although the supervision authorities are different in some countries. For instance, banking supervision is conducted in Brazil by the country's central bank, in Colombia by the Financial Superintendency, in Chile by the Superintendency of Banks and Financial Institutions, in Mexico by the National Banking and Securities Commission and in Peru by the Superintendency of Banking, Insurance and Private Fund Administrators.

<sup>6</sup> The aforementioned reports are available online: Relatório de Estabilidade Financeira (Brazil), Reporte de Estabilidad Financiera (Mexico), Financial Stability Report (Chile), Reporte de Estabilidad Financiera (Colombia) and Reporte de Estabilidad Financiera (Peru).

#### Box 2

# RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS AND THE RISKS TO FINANCIAL STABILITY ACCORDING TO THE REGION'S CENTRAL BANKS (cont'd)

Figure 1

The central banks of the main economies in the region highlight specific risks



#### **MEXICO**



## Political / geographical risk

Political and social uncertainty is one of the main domestic drivers behind the increase in perceived systemic risk during the first half of 2023



#### Credit risk

Credit to private non-financial corporations continues to decline after ten consecutive months of contraction.

The probability of default is projected to rise for consumer loans.

Credit default risk is noted for export sector firms, whose revenues are vulnerable to the global economic slowdown.



#### Resilience of the financial and fiscal system

Ratings agencies covering sovereign and Petróleos Mexicanos (Pemex) debt emphasise the risks associated with a possible impairment of the sovereign credit profile and unexpected macroeconomic developments that could result in Pemex requiring extraordinary support. Credit rating downgrades for these entities could have a broader impact on the cost of financing in the economy.



### COLOMBIA



#### Credit risk

A lower growth outlook and a higher debt burden have impaired the stock of consumer loans. Similar developments are expected in business loans to the construction, wholesale and retail, and hospitality sectors.



#### Exchange rate risk

One-third of private corporate loans denominated in foreign currency lack any kind of hedge (financial or natural).



# Resilience of the financial and fiscal system

Declining profitability for lending institutions and low profitability for non-bank financial institutions.

High fiscal and external deficits, along with significant holdings of government bonds by foreign investors, magnify the economy's vulnerability to changes in global financial conditions.



## PERU



#### Political / geographical risk

The interruption of business activities during the first quarter as a result of social unrest and climate factors (El Niño).

Road blockades due to demonstrations have affected profitability in the mining industry, prompting higher material and supply costs.



#### Credit risk

Domestic unrest and climate events have impaired credit quality impairment in certain regions where lending to SMEs predominates.

Political uncertainty has also translated into lower lending to large firms.



#### Resilience of the financial and fiscal system

As in Chile, pension fund withdrawals have had a negative impact on long-term financing.

SOURCE: Banco de España.

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Figure 1

The central banks of the main economies in the region highlight specific risks (cont'd)



#### BRAZIL



#### Political / geographical risk

Concern over the high risk of weather events (heavy rainfall) in the medium term (2030 onwards). Municipalities, which raise a large share of their credit through the financial system, are particularly exposed to these risks.



#### Credit risk

Slowdown in the growth of lending to SMEs, alongside higher risk and rising NPLs.

Growth in troubled loans among large firms after the retail chain Lojas Americanas was granted bankruptcy protection.

Moreover, lending to households has slowed due to higher perceived risk and deteriorating ability to pay.



#### Resilience of the financial and fiscal system

The weaker growth outlook for 2023 is reflected in lower rates of credit growth, high NPL ratios and stronger inflation.

Lower profitability in the banking system as a result of a greater materialisation of credit risk and, therefore, provisioning expenses. All exacerbated by the bankruptcy of Lojas Americanas.

There is notable uncertainty over fiscal policy, new fiscal framework and sustainability of public debt.



### CHILE



#### Political / geographical risk

Latent risk of the adoption of measures allowing additional withdrawals from private pension funds, which could trigger an abrupt correction of Chilean financial asset prices.



#### Credit risk

A deterioration in the financial position of households associated with the support measures deployed during the pandemic. These measures provided a temporary boost to households' liquidity. However, they gave rise to ongoing increases in consumption, lower savings and higher and persistent inflation

High NPL ratios in business loans to the wholesale and retail, construction and real estate sectors, along with lending to small firms and lower-income households



#### Resilience of the financial and fiscal system

Although withdrawals from pension funds (18% of GDP) have helped raise households' liquidity, they have also reduced their ability to save and increased the cost of long-term borrowing. This limits the financial system's shock-absorbing capacity.

Moreover, after a decade of sustained growth, public debt is projected to stand at 41% of GDP in 2027, reducing the fiscal space to contend with adverse shocks.

SOURCE: Banco de España.

#### How to cite this document

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